

Service Date: October 18, 1994

DEPARTMENT OF PUBLIC SERVICE REGULATION
BEFORE THE PUBLIC SERVICE COMMISSION
OF THE STATE OF MONTANA

* * * * *

IN THE MATTER Of The Application)	UTILITY DIVISION
Of The Montana Power Company For)	
Authority To Change Rates For)	DOCKET NO. 93.7.29
Electric Service)	ORDER NO. 5735d

* * * * *

ORDER ON RECONSIDERATION

Findings of Fact

Background

1. On June 17, 1994 the Montana Public Service Commission (Commission) issued Final Order No. 5735c setting forth its decisions on the cost of service and rate design issues in Montana Power Company (MPC or Company) Docket No. 93.7.29. On July 7, 1994 MPC filed a motion for reconsideration of certain decisions contained in Order No. 5735c.

2. MPC's motion seeks reconsideration of three issues: (1) sharing Rhone-Poulenc Chemical's (RPC) past and prospective revenue shortfalls; (2) rounding Customer Charges to the

nearest nickel; and (3) the process to review environmental externalities . In addition, MPC commented on finding of fact (FOF) 117, Order No. 5735c. MPC's comment regards the appropriateness of various cost concepts in a marginal cost study. Prior to addressing these issues, however, the Commission will address MPC's objection to the additional issues procedure.

The Commission neglected to address this objection in the Final Order.

Objection to Additional Issues Procedure

3. On December 14, 1993 MPC filed additional issues testimony pursuant to Notice of Commission Action (November 23, 1993) and Procedural Order No. 5735, as revised. Along with this testimony MPC filed an Objection to the Public Service Commission's Procedures for Addressing Additional Issues. For the following reasons, MPC's objection is overruled.

4. MPC stated its objection as follows:

Most recently, in Docket 93.6.24, MPC has stated its concerns about the additional issue procedures. Here, we reemphasize the central theme. The procedures do not require the Commission to frame a definitive issue, either factual or legal, or to assert a concrete position regarding a proposed adjustment. As a result, MPC must respond to general areas of inquiry, without knowing which particular part of its case, if any, for which the Commission believes MPC has not met its burden of proof. Because the procedure allows the Commission to identify

general areas of inquiry and not specific issues, the procedures afford neither adequate notice of specific issues nor a meaningful opportunity to respond to specific issues in accordance with due process requirements outlined in Exhibit A.

Objection, pp. 1-2. Exhibit A, incorporated by MPC in its Objection, is the Comments of the Montana Power Company, Montana-Dakota Utilities and U.S. West Communications in Docket No. 90.7.44, In the Matter of the Montana Public Service Commission's Solicitation of Comments and Suggestions Regarding its Decision Making Process.

5. The Comments filed by MPC in Docket No. 90.7.44 were in response to a Commission Notice of Inquiry. The Notice of Inquiry was issued to address strenuous due process objections from several utilities that the Commission was deciding issues that had not been litigated. The utilities argued that the Commission had a de facto adversarial staff that introduced evidence in the form of data requests and then recommended adjustments based on issues that the parties had not had the opportunity to confront. See also Docket No. 88.6.15, Order No. 5360e, pp. 31-41; Docket No. 88.11.53, Order No. 5399b, pp. 5-17; Docket Nos. 88.1.2, 88.9.33, 88.8.44, Order No. 5354e, pp. 9-17.

6. The Commission adopted the additional issues procedure in response to utility due process objections. The procedure

recognizes 1) the right of parties to confront issues prior to decision and 2) the special role of the Commission as both a decisionmaker and a regulator with an independent interest in just and reasonable rates and adequate service. In a typical rate case a utility files testimony and data to support a revenue increase or other request. Intervenor parties, most conspicuously the Montana Consumer Counsel on the revenue side, respond with answer testimony and data challenging certain parts of the utility filing. Through the filing of answer testimony certain issues are joined for Commission decision.

7. On the basis of independent investigation, however, the Commission may conclude that the utility filing raises certain issues that have not been addressed, or have not been adequately addressed, by intervenors. These issues are then framed as additional issues, and all parties are given the opportunity to conduct additional discovery and file additional testimony. Utilities are given the opportunity to file rebuttal testimony. The Commission does not decide issues that have not been joined through either the initial round of intervenor testimony, the additional issues procedure, or, in rare cases, a reserved issues procedure. The additional issues procedure does not always serve to present issues adequately for decision. In that case an issue may be referred to a future docket, or reserved for further evidence and argument in the current docket. See, e.g., Docket

No. 90.6.39, Order No. 5484z, a Final Order on Reserved Issues that were raised initially as additional issues.

8. MPC complains that the additional issues procedure does not "require the Commission to frame a definitive issue, either factual or legal, or to assert a concrete position regarding a proposed adjustment." This indicates a failure to understand the Commission's role generally, and the additional issues procedure specifically. The Commission is the decisionmaker, not a party to a rate case. As decisionmaker the Commission does not assert positions or propose adjustments. The Commission is also a regulator. As a regulator the Commission has an obligation to raise issues in an effort to ensure that the record is complete and will support a range of reasoned decisions. The Commission raises additional issues, but it is the parties that give voice to the additional issues on the record, not the Commission. It is the parties that may propose adjustments based on additional issues, not the Commission. MPC obviously has notice of any such proposed adjustments and an opportunity to respond.

9. MPC also writes that it "must respond to general areas of inquiry, without knowing which particular part of its case, if any, for which the Commission believes MPC has not met its burden of proof." Once again, this indicates a misconception that additional issues are Commission conclusions about a utility filing. They are not conclusions, they are questions; they are

inquiries into the proper ratemaking treatment of particular issues; they are not conclusions that MPC has failed to meet its "burden of proof." The Commission has suggested that the term "burden of proof" should be dispensed with in rate case proceedings. Order No. 5484p, Docket No. 90.6.39, p. 20. As MPC has argued, on revenue requirements issues a utility has a burden of persuasion, and there is a presumption that this burden is met absent evidence to the contrary. See Comments of MPC et al., p. 13, Docket No. 90.7.44, quoting Re Central Vermont Public Service Comp., 83 P.U.R. 4th 532, 566 (1987). (This assumes, of course, that a utility complies with minimum filing requirements and otherwise presents a prima facie case.) The additional issues procedure gives intervenors the opportunity to challenge the presumption in favor of a utility by presenting additional evidence and argument. If intervenors fail to provide additional evidence, then the presumption remains with the utility, unless the Commission chooses to present evidence through a split staff or an outside expert. On the cost of service/rate design portion of a rate case, which includes this Docket, burden of persuasion is generally not a relevant concept. See, e.g., Order No. 5484r, Docket No. 90.6.39, para. 23.

10. Finally, MPC asserts that additional issues "afford neither adequate notice of specific issues nor a meaningful opportunity to respond to specific issues in accordance with due

process requirements...." This is not correct. MPC has the same notice and opportunity to respond that it has with respect to intervenor answer testimony. The Commission is aware that additional issues requiring significant new discovery, analysis and argument may be difficult to process within a nine month procedural schedule. But for those few issues that are too big to handle under the nine month schedule the Commission can invoke a reserved issue proceeding, or refer them to a subsequent filing. In either case, the utility has abundant notice and opportunity to respond.

MPC's Motion

Revenue Sharing

11. MPC's motion seeks reconsideration of the Commission's decision requiring the Company's shareholders to absorb 10 percent of the historical and prospective revenue shortfalls.

12. MPC argues that sharing the revenue shortfall is inconsistent with the Commission integrated least-cost planning (LCP) guidelines. ARM 38.5.2001-2012. MPC asserts the LCP guidelines provide the policing mechanism for retention rates such as the EIRI-2. MPC contends the LCP guidelines are inconsistent with the Commission's competitive market standard and the Commission's encouragement of the Company to strike hard bargains with retention customers.

13. MPC claims that conspicuously absent from the Commission's decision is any reference to ARM 38.5.2008 (2), the LCP rule which addresses retention rates. (MPC Exh. No. 22, p. 18):

If a utility is faced with the potential loss of a large industrial load and is considering a request for a retention rate, it should use least cost planning methodologies and tools to evaluate the impacts of retaining or losing the load and to consider alternatives such as efficiency improvements and pricing alternatives.

MPC maintains that this sentence provides the general guidance on how to deal with revenue shortfalls associated with the loss of industrial loads. MPC contends no evidence exists that it did not follow the guidelines when designing the EIRI-2 tariff. MPC states that it designed the tariff to meet the goal of retaining RPC's load subject to the constraint that it recover relevant costs. MPC claims to have maximized the rates it can charge RPC.

14. MPC argues that the Commission's decision to require a sharing of the revenue shortfall misinterprets the guidelines; MPC contends the guidelines do not contemplate shareholders absorbing part of the cost to retain a customer, and they do not support the Commission's apparent reliance on the disciplining force of competitive markets or the need for incentives for MPC to strike hard bargains with retention customers. MPC concludes

that the Commission's decision increases risk and confuses the guidelines.

Commission Decision

15. The Commission denies MPC's motion on revenue sharing. MPC's motion on sharing raises two separate issues. The first is whether MPC's ratepayers should absorb all of the shortfall associated with the EIRI-2 tariff; the second is whether the Commission's decision is inconsistent with ARM 38.5.2008(2).

16. In Order No. 5735c the Commission concluded that MPC's cost justification of the EIRI-2 was only minimally acceptable. Nothing in MPC's motion causes the Commission to change this conclusion. The Commission finds revenue sharing should continue for the following reasons.

17. First, RPC's precise cost responsibility is unknown. This is evident, in part, from the Stipulation between MPC and others on how to compute costs in this Docket. Although MPC demonstrated that the EIRI-2 rates exceeded the short-term nonfirm opportunity cost of energy, only MPC may know whether higher-valued foregone uses of the power consumed by RPC exist.

18. Other costs, such as transmission costs, may also exist that should be allocated to RPC. MPC asserts that its lack of obligation to serve RPC frees RPC from such cost responsibility; MPC admits, however, that it may still serve the plant's load

after July 1996. If in two years MPC still serves RPC's load, then the Commission will not be able to reach back and recover costs that, in hindsight, were RPC's responsibility. MCC argued that because RPC was not allocated transmission costs, the cross subsidy is exacerbated. MCC added that the only justified long-run credit RPC should receive for being interruptible is the cost of a peaking unit (TR 334).

19. This debate raises the question of what kinds of customer load durations should be allocated long-term generation and transmission capacity costs. MPC claims to have estimated both its transmission and generation capacity costs using long-term trends. While MPC allocated long-term generation capacity costs to RPC's short-term load, it chose not to allocate long-term transmission capacity costs to RPC's short-term load. In estimating its transmission capacity costs using a long-term trend, MPC did not clearly show that the resulting costs were only allocable to long-term loads. That is, it is not obvious that short-term loads, such as RPC's, are not also responsible for MPC's estimate of transmission capacity costs.

20. Assuming RPC should be allocated transmission capacity costs, then what is the range of impacts on RPC's cost responsibility? Even with MCC's low transmission cost estimate RPC would be responsible for several hundred thousand dollars in increased costs. If MPC's transmission costs are accurate, then

RPC could have been allocated millions of dollars of additional costs (\$49.42/kw times 74,000 kw or \$3,657,080 per year), further exacerbating MCC's cross subsidy concern.

21. A final point in regard to transmission involves the relation between MPC's stranded transmission rate base testimony before the FERC and MPC's proposed treatment of the transmission plant left if RPC ceases to be an MPC customer (TR 506-507). MCC perceives a contradiction between MPC's argument in this case and its testimony before the FERC. On the one hand, MPC asserts the reduced rate to RPC is cost justified and that there is no subsidy. On the other hand, Mr. Pascoe's comments to FERC on transmission access caution against granting open transmission access. The caution stems from the concern that loads leaving the system create stranded costs for which MPC must be compensated. MCC finds inconsistent MPC's different rationalizations for similar circumstances: RPC's ceasing service creates benefits while the loss of a wholesale load creates costs. The two positions appear to be inconsistent.

22. Second, MPC contends that RPC's revenues and costs are aligned, absent reconciliation. Reconciliation is a moot issue in this Docket, given the decision to freeze costs. Had the Commission adopted certain cost proposals, the process of reconciliation would have raised RPC's revenue requirement over that level reflected in the EIRI-2 rates. MPC stated RPC is

unable to pay fully cost-based interruptible rates established in Docket No. 90.6.39 (MPC Exh. No. 22, p. 20). Given that EIRI-2 rates are all RPC is willing to pay, any increased revenue requirement from reconciliation, which RPC is unwilling to pay, must be shifted to all other customers. Thus, revenues and costs are not aligned when reconciliation is, as it must be, taken into account.

23. Third, MPC claims (Initial Brief, p. 42) to have analyzed RPC's market environment when it developed the proposed EIRI-2 rate. In conjunction with this assertion, MPC's brief states that "Utah Power and Light's rates to Monsanto are based on short-term costs." It is not clear, however, whether Monsanto's rates are based on embedded or marginal costs. If based on embedded costs, this represents an indirect introduction of embedded cost pricing practices in Montana. Because RPC's competitors in other states can obtain embedded cost rates, MPC's electric customers are impacted. Embedded-cost pricing is not the policy direction of either the LCP guidelines or the subsequent rules on Minimum Filing Standards.

24. In addition to the above, the Commission finds MPC's reliance on ARM 38.5.2008(2) unpersuasive. The LCP guidelines are exactly that -- guidelines. They are not the only basis for policy decisions. Flexibility underlies the ratemaking process in general and, in particular, the cost of service and rate

design (COS and RD) process. On other issues MPC may want to deviate from the apparent direction of the guidelines. MPC claims the LCP guidelines embody the most recent substantive expression of Commission regulatory policy. Subsequent to the issuance of the LCP rules, however, the Commission revised its Minimum Rate Case Filing Standard rules. See ARM 38.5.176 - 38.5.195, amended as of 9/30/93. These rules culminated a year and a half of round table meetings with MPC, and others, on how cost of service ought to be performed. No participant argued that the LCP guidelines take precedence over the Minimum Filing Standard rules. The guidelines and rules are largely complementary.

25. The Minimum Rate Case Filing Standard rules guide parties on what an allocated marginal COS and RD study, and the associated testimony, should include. Importantly, the rules allow market values to reflect the highest valued foregone use of the generation resources otherwise consumed by customers. The highest forgone use (opportunity cost) is used to set prices. These rules were lenient in terms of the relevant time horizons allowed for cost estimates.

26. The Minimum Filing Standard rules refrained from prescribing explicit costing methods, in part because of a near consensus among the round table participants opposing such constraints; the participants wanted the flexibility to propose

their own costing methods. For example, while MPC used a BPA sale as a proxy for opportunity costs (the highest valued foregone use), others selected alternative opportunity costs (MCC Exh. No. 2, p. 4). Just as parties have flexibility to choose differing COS and RD policies, so does the Commission have flexibility in regulating firms with monopoly power. The Commission finds that requiring revenue sharing does not violate the LCP guidelines and Minimum Rate Case Filing Standard rules.

27. For the above reasons the Commission reaffirms its decision requiring MPC's shareholders to absorb 10 percent of the historical and prospective revenue shortfalls arising from the EIRI-2 tariff.

Rounding Customer Charges to the Nearest Nickel

28. Based on historical precedent, the Commission ordered MPC to round Customer Charges to the nearest nickel (FOF 122). MPC seeks to limit the policy to the residential class as reflected in its compliance filing.

Commission Decision

29. The Commission grants MPC's request.

Reserved Issue: Transmission, Distribution Costs

30. Order No. 5735c raised a general issue but then focused on a specific application. The general issue is the use of avoided, opportunity and marginal cost concepts in a cost study (FOF 116). The specific issue involves the Commission's reference to avoided transmission and distribution costs that MPC developed in Docket No. 93.6.24 for COS and RD purposes in this Docket.

MPC=s Comment

31. MPC asserts that because the Commission refers to cost data from another docket, a difference of opinion exists between the Commission and the Company on marginal cost definitions. Because the cited costs are not associated with changed loads, MPC chose to exclude such costs from its marginal cost study.

Commission Response

32. The Commission routinely receives cost testimony that applies avoidable, marginal or opportunity cost concepts to the issues of costing and pricing. This Docket was no different. Nor is it uncommon, or inconsistent, to use a mix of cost concepts in a cost study. In this Docket MPC and MCC each used a mix of avoidable, opportunity and marginal costs in their respective cost studies (see Order No. 5735c, FOF No. 50 and MCC's March 25, 1994, Initial Brief, p. 12). For example, MPC's

own marginal energy costs derive from an opportunity cost analysis. MPC then labels the opportunity costs avoided costs and uses the same to derive marginal energy costs. This mixing of terminology arises, in part, because in most hours MPC buys and sells (arbitrages) nonfirm power in the off-system market (TR 468). Cost analysis must move beyond a semantic debate to constructively estimate the economic value of various factors of production in a cost study.

33. MPC's comment that costs do not belong in a marginal cost study if there is no associated load change is generally incorrect. This comment is also inconsistent with the Company's own Docket No. 93.7.29 testimony. MPC's cost study contains costs unrelated to load changes. For example, MPC includes the cost of meters in its marginal cost study although there is no load change, or change in customer count. Also, when a power contract's term expires and replacement power is acquired, there is no change in load; however, MPC includes the replacement costs in its marginal cost study (see, e.g., MPC Exh. No. 15, p. 6; HRC Data Response PSC-123,b; MCC Data Response PSC-143 and MPC Exh. No. 6, p. 38).

34. Valid reasons exist to include the analysis of avoidable, marginal and opportunity costs in a cost study. While it may be wrong to call a marginal cost an avoidable cost, the

real economic issue is an inquiry into the highest valued foregone use of society's scarce resources.

MPC's Next Cost of Service Filing

35. The Minimum Rate Case Filing Standard rules require that a benchmark cost study be compared to the current cost study. ARM 38.5.176(1)(b). When it files its next cost study, MPC should use the same benchmark study it used in Docket No. 93.7.29. This is because no cost study was approved in Docket No. 93.7.29. Also, MPC should include RPC's load in the next cost study's benchmark analysis; RPC was left out of its benchmark analysis in Docket No. 93.7.29.

Additional Issue

Environmental Externalities

36. In Order No. 5735c the Commission directed MPC to conduct a thorough search of data sources and develop a range of marginal damage cost estimates applicable to its generation, transmission and distribution of electricity, as well as for off-system power purchases (FOF 112). The Commission directed that the damage estimates be stated in terms of dollars per unit of consumption (access, KW, Kwh). The Commission stated that, at a minimum, MPC should estimate the damage costs associated with Carbon Dioxide (CO₂), Sulfur Oxides (SO_x), Nitrogen Oxides (NO_x),

Volatile Organic Compounds (VOC) and Particulates. The Commission directed MPC to provide cost estimates for these externalities in its next rate filing and stated that the ultimate purpose for the estimates is efficient pricing. The Commission based its decision on its integrated least cost planning rules which relate ratemaking and integrated resource planning and acquisition. ARM 38.5.2001 and 2008.

MPC's Motion

37. MPC contends that defining and quantifying marginal external costs may be "an order of magnitude more difficult than all the other traditional marginal cost questions combined." MPC also suggests that there are so many other important issues that need to be addressed in the next allocated cost of service rate design case that the externality issue may only get superficial attention, on the other hand, it may take up too much time and other important issues will suffer. MPC states that the agenda for the next case is already full without the added burdens of "a complete study and discussion of the scope, quantification, and incorporation of marginal external costs in the design of customer rates." For these reasons MPC argues that the Commission should open a separate proceeding which can focus exclusively on externalities.

Commission Decision

38. The Commission denies MPC's motion. The Commission agrees with MPC that the task of quantifying and incorporating external costs into customer rates will probably be both difficult and contentious. The Commission also agrees that the issue deserves serious attention. The Commission does not agree, however, that the attention the issue will get if it is included in the next rate design case will necessarily be either superficial or excessive. To some extent, the attention the issue will get depends on what information MPC is able to present when it files its case. Order No. 5735c, FOF 112 directs MPC to conduct a search of data sources and develop a range of damage cost estimates to present in its next case; MPC will not be proposing a single value which it must defend. Other parties will critique MPC's data sources and estimated cost ranges. Depending on the evidence, the Commission may or may not decide to incorporate damage costs into customer rates, although that is the ultimate goal (FOF 114).

39. For the following reasons the Commission chooses not to open a separate proceeding to determine appropriate damage costs and the appropriate means of incorporating them into customer rates. First, once that proceeding were complete a rate case would still be needed to adjust customer rates. There would be no guarantee that all parties to the rate case would have

participated in the separate externalities proceeding, or that all issues would have been settled to the satisfaction of the parties that did participate in the externalities proceeding. Therefore, the externality issue could still be contentious in a rate case.

40. Second, the Commission does not necessarily expect complete resolution of the externality issue in the next case. As has been the case with costing issues in general, there is no reason to expect that the externality issue can be completely resolved in a single case. However, incremental progress will be made toward achieving the ultimate goal. Since rate cases are needed to incorporate costs into rates anyway, the Commission finds taking small steps in rate cases is better than trying to take one big step in a separate proceeding.

41. Third, the Commission finds that MPC has, through its Least Cost Planning Advisory Committee, a forum in which to discuss with potential rate case intervenors issues related to externalities.

CONCLUSIONS OF LAW

1. All Findings of Fact are hereby incorporated as Conclusions of Law.

2. The Applicant, Montana Power Company, furnishes electric service for consumers in the State of Montana and is a

"public utility" under the regulatory jurisdiction of the Montana Public Service Commission. Section 69-3-101, MCA.

3. The Montana Public Service Commission properly exercises jurisdiction over Montana Power Company's rates and operations. Section 69-3-102, MCA, and Title 69, Chapter 3, Part 3, MCA.

4. The Montana Public Service Commission has provided adequate public notice of all proceedings and an opportunity to be heard to all interested parties in this Docket. Sections 69-3-303 and 69-3-104, MCA, and Title 2, Chapter 4, MCA.

5. The Cost of Service and Rate design approved herein are just, reasonable, and not unjustly discriminatory. Sections 69-3-330 and 69-3-201, MCA.

ORDER

THE MONTANA PUBLIC SERVICE COMMISSION HEREBY ORDERS:

1. The Montana Power Company shall comply with each requirement and direction of this Order as described above.

2. The Montana Power Company's requests for reconsideration are granted and denied as described above.

3. The Montana Power Company may request reconsideration of the Commission's decision at paragraphs 3-10 of this Order.

Done and Dated this 11th day of October, 1994 by a vote of 5-0.

BY ORDER OF THE MONTANA PUBLIC SERVICE COMMISSION

BOB ANDERSON, Chairman

BOB ROWE, Vice Chairman

DAVE FISHER, Commissioner

NANCY MCCAFFREE, Commissioner

DANNY OBERG, Commissioner

ATTEST:

Kathlene M. Anderson
Commission Secretary

(SEAL)

NOTE: You may be entitled to judicial review in this matter.
 Judicial review may be obtained by filing a petition
 for review within thirty (30) days of the service of
 this order. Section 2-4-702, MCA.

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